What Really Happened To LUNA Crypto?

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Key takeaways

- When the Luna crypto network collapsed, it's estimated that $60 billion got wiped out of the digital currency space.
- Algorithmic stablecoins (UST) are not the same as Tether or USD Coin, which are backed by actual dollars or assets stored in a bank.
- An arrest warrant has been issued for Do Kwon, the co-founder of Terraform Labs, where the sister tokens Luna and TerraUSD were held.

Terra network and its leader, Do Kwon, rose to prominence in the cryptocurrency world over the course of four years, all ending in a disastrous fall from grace. The Luna crypto network collapsed in what's considered the largest crypto crash ever, with an estimated $60 billion wipeout, shaking the global digital currency market.

There are two stories regarding Luna crypto: the TerraUSD/UST stablecoin and the actual Luna coin. Once Luna and UST crashed, there was a total liquidity crunch in the cryptocurrency space that caused an even more catastrophic loss of value. The crypto community still hasn't recovered.

In order to understand what happened, let's review what happened step by step.

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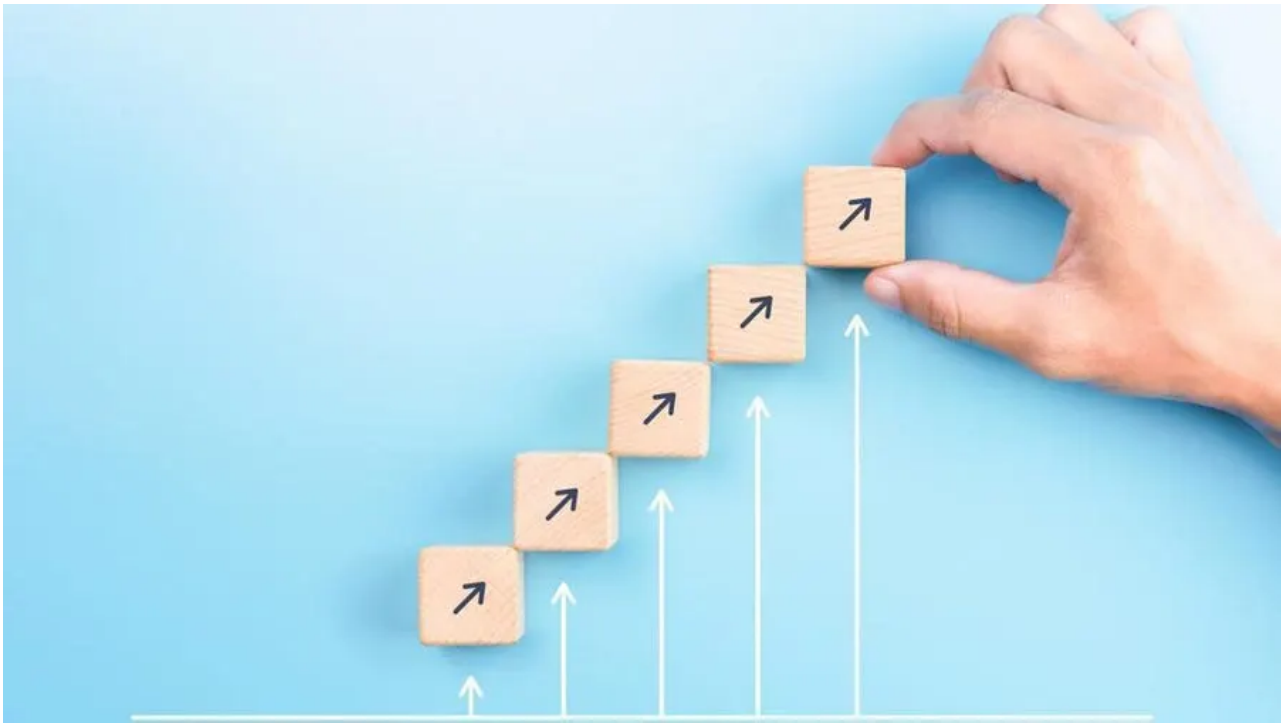

What is Luna crypto exactly?

You may have heard of TerraUSD and Luna, here is a quick breakdown of what they are exactly. Lots of moving parts within the Luna network ahead of its collapse.

TerraUSD (also known as UST) and Luna are two sister coins on the same network.

Terra is a blockchain network, similar to Ethereum or Bitcoin, that produces Luna tokens. The network was created in 2018 by Do Kwon and Daniel Shin of Terraform Labs.

Terraform Labs created the UST coin to be an algorithmic stablecoin on the Terra network. While other stablecoins (USDC or Tether) are fiat-backed, the UST would not be backed by real assets. Instead, the value of UST would be backed by its sister token, Luna. More on that later.

Stablecoins are supposedly safe havens in the crypto space since they're meant to have a fixed value of around 1 USD. The goal being, a steady

store of value for investors, unlike other volatile coins (like ethereum).

Luna was Terra's blockchain native token, similar to how ether is used on the Ethereum network. Luna had four different roles in the Terra network:

1. A method to pay for transaction fees in the Terra network.
2. A mechanism for maintaining Terra's stablecoin peg.
3. Staking in Terra's delegated proof of stake (DPoS) to validate network transactions.
4. Participation in the platform's governance by adding to and voting on proposals when it comes to changes in the Terra network.

How much was Luna worth?

A Luna coin was going for around $116 in April and ended up dropping to a fraction of a penny before being delisted. Before that, the coin went from being worth less than $1 in early 2021 to creating many crypto millionaires within a year. This led to Kwon's cult hero status among (some) retail crypto investors. Many success stories popped up in the media about how regular folks were able to get rich from Luna.

The Luna token skyrocketed about 135% in less than two months until its peak in April 2022. The largest incentive was that you could stake your UST holdings on the Anchor lending platform for a 20% annual yield. Many analysts felt that this absurd rate was unsustainable.

The Anchor Protocol was a decentralized money market built on the Terra blockchain. This platform became popular for its aforementioned 20% yield for UST holders who deposited their tokens on the platform. Then Anchor would turn around and loan the deposit to another investor. Many skeptics were concerned about where the money came from to pay these rates. Some considered this an obvious Ponzi scheme. At one point, as much as 72% of UST was deposited in Anchor because the platform was the primary driver of demand for Terra.

What happened to UST?

Before we look at this crypto disaster, we need to discuss stablecoins briefly. A stablecoin is pegged to a more stable currency like the US dollar. Tether and USDC are both tied to USD. Stablecoins are used to hedge against volatility in the crypto space. For example, let's say that Ether's price is $1,000. You could exchange one Ether for 1,000 USDC tokens. When investors expect a hit in the crypto market, they put their money into stablecoins to protect their assets.

The UST coin was not backed by an actual US Dollar but rather an algorithmic stablecoin. The belief was that Terraform Labs could use clever mechanisms along with billions in Bitcoin reserves to maintain the peg of UST without the backstop of the USD.

To create UST you have to burn Luna. So, for example, when Luna token's price was $85, you could trade one token for 85 UST. This deflationary protocol was designed to ensure there was long-term growth for Luna.

For UST to retain its peg, one UST could be changed for $1 worth of Luna at any time. If UST slipped, traders could make money from buying UST and then exchanging it for Luna.

Both Luna and UST crashed once UST lost its peg to the dollar, which was what qualified it as a stablecoin.

TerraUSD was risky because it wasn't backed by cash, treasuries or other traditional assets like the popular stablecoin tether. The stability of UST was derived from algorithms that linked the value to Luna. Many experts were skeptical that an algorithm could keep two tokens stable.

Why did LUNA crash?

The Luna crypto crash was caused by its connection to TerraUSD (UST), the algorithmic stablecoin of the Terra network.

On May 7, over $2 billion worth of UST was unstaked (taken off the Anchor Protocol), and hundreds of millions of it were quickly liquidated. There's debate as to whether this happened as a response to rising interest rates or if it was a malicious attack on the Terra blockchain. The huge sell-offs brought down the price of UST to $0.91, from $1. As a result, traders started to change 90 cents worth of UST for $1 of Luna.

Once a large amount of UST had been offloaded, the stablecoin started to depeg. In a panic, more people sold off UST, which led to the minting of more Luna and an increase in the circulating supply of Luna.

Following this crash, crypto exchanges started to delist Luna and UST pairings. Long story short, Luna was abandoned as it became worthless.

What happened after the Luna crash?

The Luna meltdown impacted the entire cryptocurrency market, which was already highly volatile and experiencing difficulty at the time. It's estimated that the Luna crash ended up tanking the price of bitcoin and causing an estimated loss of $300 billion in value across the entire cryptocurrency space.

Crypto leaders Voyager and Celsius filed for bankruptcy. Three Arrows Capital (3AC) was forced into liquidation.

Many people lost their life savings and suffered financial hardships due to the Luna crypto crash. If you do a quick search online, you'll find many of these terrible stories. Many loyal Luna fans (who referred to themselves as "Lunatics") took to Reddit threads to share their disastrous stories. One retail crypto investor even confessed that they lost their savings of $20,000 in Luna.

The only winners were those who exited their positions before the crash. One winner that we have to highlight is the hedge fund Pantera Capital. They saw a 100x return on an initial investment of $1.7 million. The company liquidated its Luna position prior to the collapse for a

return of $171 million.

What happened to the Luna crypto founder?

Do Kwon shared a recovery plan for Luna, and things looked promising for a brief period of time in May after the original crash. But the coin ultimately plummeted. It was promptly abandoned. Terra ended up launching a new coin, Luna 2.0.

On September 15, it was announced that a court in South Korea had issued an arrest warrant for Do Kwon. This came almost four months after the collapse of Luna and UST, the two tokens that Terraform Labs issued. Do Kwon and five other people are currently accused of violating local market laws.

Officials in South Korea seek to revoke Kwon's passport as they believe he's currently residing in Singapore. In theory, if this legal action goes through, Kwon would have to return to South Korea within 14 days of receiving the notice of the revocation. The ministry is currently evaluating the request.

Some investors who lost money in Luna have filed a complaint with local prosecutors claiming that Kwon was involved in fraud and illegal fundraising. It's estimated that about 280,000 people in South Korea had invested money in Luna.

How should you be investing?

If you're looking to invest in the cryptocurrency space, you may want to consider one an investment kit like our Crypto Kit or Emerging Tech Kit. Both kits help spread risk across industries, not just investing in a single coin or company, but the entire ecosystem. They both use AI to allocate portfolio weights each week across four vertices: crypto, tech ETFs, large tech companies and small tech companies. Users can activate Portfolio Protection at any time to protect your gains and reduce your losses, no matter what industry you invest in.

The bottom line

If you're going to invest in digital currency and other particularly volatile assets, you have to accept that there's going to be some outsized risk associated with it. Hopefully, this disastrous Luna collapse is more of a cursory, black swan event than the start of an era. The key takeaway should be that if an investment seems too good to be true, it usually is. Secondarily, for investors who are still bullish on crypto over the longhaul, it would be prudent to limit these investments to 5-10% of one's portfolio.

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